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Date:

June 07, 2006

LEGEND

Company =

LLC 1 =

LLC 2 =

Operating Company =

Historic Building =

Government Entity 1 =

Government Entity 2 =

Government Entity 3 =

Building 1 =

Building 2 =

Site =

University =

State =

City =

X =

Affiliate A =

Affiliate B =

Development Company =

Zone =

A square feet =

B square feet =

C square feet =

D square feet =

E square feet =

F square feet =

Year A =

Year B =

Y Acres =
Z percent =
SB/SE Official =

Dear :

This is in response to your letter dated January 30, 2006, and subsequent correspondence requesting rulings under section 168 (h)(1)(B) of the Internal Revenue Code on behalf of Company regarding a multifaceted transaction that includes the rehabilitation of Historic Building.

FACTS

Company is a limited partnership. The general partner of Company is LLC1, a single-member limited liability company. The owner of LLC 1 is LLC 2, a single-member limited liability company wholly owned by Operating Company. It is coordinating the development described below with two affiliated entities, Affiliate A and Affiliate B.

Company, Affiliate A, and Affiliate B are in the process of acquiring and rehabilitating Historic Building and constructing two new buildings located in the Zone. The Historic Building and an annex (the Annex) are owned by Governmental Entity 2. Company will acquire the Historic Building and underlying land directly from Governmental Entity 2. The University, a tax-exempt entity, will acquire the Annex and underlying land from Governmental Entity 2, together with certain other land. Affiliate A will execute a long-term (in excess of sixty years) ground lease and air rights agreement with the University for the land under the Annex (the Ground Lease). Affiliate A will then demolish the Annex (except for the "Annex Tunnel") and build Building 2, a new mixed-use building, on the land leased from the University. Near Historic Building is an inter-city and regional rail center (the Station) owned by X and open to the public. X owns certain other property located within the Zone and has executed a long-term (in excess of 99 years) ground lease and air rights agreement with Affiliate B, which is constructing Building 1, a new office building, thereon.

In order to promote the redevelopment of areas that are blighted, State has enacted legislation that permits the designation of blighted areas and permitting certain tax exemptions, deductions, abatements and credits to businesses that operate in those areas. One area designated for redevelopment is the Zone, an area that includes the Historic Building, Building 1, and Building 2.

Affiliate B began to build and lease Building 1 while looking for other development opportunities in the Zone. Building 1 is located near the Station to take advantage of

convenient rail transportation for employees of businesses leasing space in Building 1. Building 1 is connected to the Station by an above street-level public bridge.

Historic Building is in the process of being listed on the National Register of Historic Places. In Year A, simultaneously with Affiliate B's planning for the construction of Building 1, Development Company began discussions with the Governmental Entity 3 regarding potential relocation to the Historic Building of certain offices of Government Entity 1 currently located elsewhere in the City. Subsequently, Operating Company executed a letter of intent with the University contemplating acquisition by the Company of the Historic Building. Affiliate A would execute the Ground Lease with the University and construct Building 2. A portion of Building 2 would be leased to Government Entity 3 for parking and other needs of Government Entity 1. This letter of intent has expired, but a new letter of intent providing substantially the same terms has been executed between Operating Company and the University.

Construction of Building 1 is almost complete, and it is almost fully leased. Beginning in Year B, Company will "substantially rehabilitate" the Historic Building. Company will lease the renovated Historic Building and Affiliate A will lease certain space in Building 2 to Government Entity 2, and Governmental Entity 2 will sublease all of this space to Government Entity 3 for use and occupancy by Government Entity 1 (Governmental Lease). While the Historic Building is being renovated, the Annex will be demolished (except for the Annex Tunnel) and Affiliate A will begin construction of Building 2. The lower levels of Building 2 will include an extensive, newly constructed parking area. The Annex is connected to the Historic Building by Annex Bridge, which will be retained (or replaced by a new bridge) and will connect the Historic Building to the bridge level of Building 2. Government Entity 3 has negotiated for inclusion of a parking area for the exclusive use of Government Entity 1 as part of the premises to be leased in Building 2. During the term of the Governmental Lease, Government Entity 1 has the exclusive right to the access, possession, use and occupancy of this parking area.

According to the submission, Operating Company will create a fully supported business center rather than a single building. Benefits to Operating Company from the renovation of the Historic Building and the construction of Building 1 and Building 2 include (i) the ability to solidify and strengthen the overall design integrity and economic viability of the entire Site; (ii) economies of scale in marketing and managing the overall Site; (iii) the ability to offer prospective tenants a broad range of leasing options within the Site; and (iv) the ability to utilize a single maintenance operation to work on the entire Site, allowing for economic sharing of equipment and personnel. To effectively manage the Site, Operating Company will have a single maintenance operation and a centralized managerial structure, which will be responsible for delivering property management and maintenance services to the entire Site. Tenants located in any building of the overall development will access the same property management organization to address their operational requirements. A series of walkways, tunnels and pedestrian bridges will connect the buildings in the Site. Moreover, in order to

create a consistent architectural theme and landscaping design which will integrate the entire Site, a single architect has been retained as the executive plan architect for the overall Site.

The submission also makes significant representations:

- (1) The economic substance of the Governmental Lease will be that of a “true lease” such that Operating Company will be treated as the owner of the Historic Building and Affiliate A will be treated as the owner of Building 2 (including the parking area exclusively for the use of Government Entity 1) for federal income tax purposes;
- (2) The rehabilitation of the Historic Building and the construction of Building 1 and Building 2 are all part of one plan or scheme to redevelop part of a Zone;
- (3) The initial term of the Governmental Lease plus any fixed rate renewal options and any service contract or similar arrangement involving the property leased under the Governmental Lease will not exceed twenty (20) years as measured from the first day any part of the leased premises is delivered and accepted as substantially complete by the tenant under the Governmental Lease (excluding pre-substantial completion access allowed to the tenant and its contractors to complete tenant improvements or to prepare for occupancy). (For purposes of this ruling request, an option to renew a lease at a rental rate equal to fair market value determined at the time of renewal will not be treated as a “fixed rate renewal option”.);
- (4) No lease of space in Building 1 to a “tax-exempt entity” (as defined in § 168(h)(2)) that is executed before the fifth anniversary of the first day the rehabilitated Historic Building is placed in service, will have a lease term, including any fixed rate renewal option and any service contract or similar arrangement involving the leased space, which exceeds twenty years;
- (5) No lease of space in Building 2 to a tax-exempt entity which is executed before the fifth anniversary of the first day the rehabilitated Historic Building is placed in service, will have a lease term, including any fixed rate renewal option and any service contract or similar arrangement involving the leased space, which exceeds twenty years;
- (6) There is not now, and will not be, any up-front understanding, informal arrangement or similar agreement between Operating Company and Government Entity 3, or between Affiliate A and Government Entity 3 that any fair market value renewal option which may be granted under the Governmental Lease will be applied by the parties without regard to the actual fair market value rental of the premises at the time of renewal;

(7) There is not now, and will not be, any up-front understanding, informal arrangement or similar agreement between Affiliate A and any other tax-exempt entity lessee that any fair market value renewal option which may be granted under a lease of space in Building 2 executed before the fifth anniversary of the first day the rehabilitated Historic Building is placed in service, will be applied by the parties without regard to the actual fair market value rental of the premises at the time of renewal;

(8) There is not now, and will not be, any up-front understanding, informal arrangement or similar agreement between Affiliate B and any tax-exempt entity lessee that any fair market value renewal option which may be granted under a lease of space in Building 1 executed before the fifth anniversary of the first day the rehabilitated Historic Building is placed in service, will be applied by the parties without regard to the actual fair market value rental of the premises at the time of renewal;

(9) No portion of Building 1, the Historic Building, or Building 2 or the improvements to be constructed thereon (including the rehabilitation of the Historic Building) will be financed, directly or indirectly, by an obligation the interest on which is exempt from tax under § 103(a);

(10) The Governmental Lease will not include, and neither Government Entity 3 nor a “related entity” under § 168(h)(4), will hold a fixed or determinable price purchase or sale option or its equivalent with respect to all or any part of the premises leased under the Governmental Lease;

(11) No other lease executed between Affiliate A and any tax-exempt entity lessee before the fifth anniversary of the first day the rehabilitated Historic Building is placed in service will include, and no such lessee or a related entity will hold, a fixed or determinable price purchase or sale option or its equivalent with respect to Building 2 or any part thereof;

(12) No lease executed between Affiliate B and any tax-exempt entity lessee before the fifth anniversary of the first day the rehabilitated Historic Building is placed in service will include, and no such lessee or a related entity will hold, a fixed or determinable price purchase or sale option or its equivalent with respect to Building 1; and

(13) Upon completion, the buildings on the Site will contain approximately the number of square feet of “Net Rentable Floor Space” set forth below.

<u>Building</u>	<u>Net Rentable Floor Space</u>
Building 1	A square feet
Historic Building	B square feet
Building 2 (excluding the Government Entity 2 Condominium):	
Retail Space	C square feet
Office Space	D square feet

Government Entity 1 Parking Area	E square feet
Total Net Rentable Floor Space	F square feet

Law and Analysis

Section 168(h)(1)(B)(i) states that, in the case of non-residential real property, the term “tax-exempt use property” means that portion of the property leased to a “tax-exempt entity” in a “disqualified lease”. Under § 168(h)(1)(B)(ii), the term “disqualified lease” means any lease of the property to a tax-exempt entity, but only if: (I) part or all of the property was financed (directly or indirectly) by an obligation the interest on which is exempt from tax under § 103(a) and such entity (or a related entity) participated in such financing, (II) under such lease there is a fixed or determinable price purchase or sale option which involves such entity (or a related entity) or there is the equivalent of such an option, (III) such lease has a lease term in excess of 20 years,¹ or (IV) such lease occurs after a sale (or other transfer) of the property by, or lease of the property from, such entity (or a related entity) and such property has been used by such entity (or a related entity) before such sale (or other transfer) or lease.

Under § 168(h)(1)(B)(iii), property will be considered “tax-exempt use property” only if the portion of the property leased to tax-exempt entities in disqualified leases is more than 35 percent of the property (the “35-percent exception”). Section 168(h)(1)(B)(iv) provides that improvements to a property (other than land) will not be treated as a separate property.

Section 1.168(j)–1T, Q&A-6, of the temporary Income Tax Regulations provides that the phrase “more than 35 percent of the property” means more than 35 percent of the net

¹ For purposes of § 168(h)(1)(B)(ii)(I), Taxpayer represents that the Historic Building, Building 1, and Building 2 will not be financed with tax-exempt debt. For purposes of § 168(h)(1)(B)(ii)(II), Company represents that there is no fixed or determinable price purchase or sale option or the equivalent of such an option for the benefit of Government Entity 3, any other tax-exempt lessee, or any related entity, with respect to any of the buildings. For purposes of § 168(h)(1)(B)(ii)(III), the Taxpayer represents that the term of the Governmental Lease and any other leases with tax-exempt entity lessees at the Site, including any fixed price renewal option and any service contract or similar arrangement with respect to the leased space, is no greater than 20 years. Any renewal option terms will be at a fair market value rental rate determined at the time of renewal and, therefore, should not be taken into account. Therefore, neither the Governmental Lease, nor any other lease of the Historic Building, Building 1, or Building 2 would presently be a “disqualified lease” under these first three provisions.

rentable floor space of the property. The net rentable floor space in a building does not include the common areas of the building, regardless of the terms of the lease. For purposes of the “more than 35 percent of the property” rule, two or more buildings will be treated as separate properties unless they are part of the same project, in which case they will be treated as one property. Two or more buildings will be treated as part of the same project if the buildings are constructed under a common plan, within a reasonable time of each other, on the same site and will be used in an integrated manner.

The Governmental Lease and the lease by Company to Government Entity 2 as they relate to the Historic Building would each be a “disqualified lease” under § 168(h)(1)(B)(ii)(IV) (the “Use After Transfer Rule”) because the Historic Building has been used by the Government Entity 2, a United States governmental entity, and will, after the acquisition of such property by Operating Company, be leased to Government Entity 3 for use by Government Entity 1, both of which are related entities to Government Entity 2 under §§ 168(h)(2)(A)(i) and 168(h)(4)(A). However, § 168(h)(1)(B)(iii) provides that property will not be treated as “tax-exempt use property” if the portion of the property leased to tax-exempt entities in disqualified leases is no more than 35 percent of the property. Although the Company acknowledges that the Historic Building will be subject to a “disqualified lease” under the Use After Transfer Rule, Taxpayer posits that the 35-percent threshold in § 168(h)(1)(B)(iii) will not be crossed because Building 1, the Historic Building, and Building 2 comprise a single “project” (*i.e.*, one property for purposes of § 168(h)) under Q&A 6 of the temporary regulations, and thus less than 35 percent of the total net rentable floor space of that project (*i.e.*, the net rentable floor space of only the Historic Building) will be subject to a disqualified lease. Therefore, no portion of the property will be “tax-exempt use property” within the meaning of § 168(h)(1)(B).

For purposes of determining if the buildings in this case should be considered part of a single “project” for purposes of Q&A-6 of the temporary regulations and § 168(h)(1)(B)(iii), the Taxpayer posits that the buildings here are constructed under a common plan, within a reasonable time of each other, located on the same site, and will be used in an integrated manner.

The Taxpayer represents that the rehabilitation of the Historic Building and the construction of Building 1 and Building 2 are all part of one plan or scheme to redevelop part of a Zone (Representation 2). We have no facts or reason to doubt or challenge this representation. For instance, early plans done by landscape architects envision this area as a single development. Further, a single architect will serve as the site plan architect for the Site. There will be a consistent architectural theme and landscape design throughout the Site.

The submission also indicates that Building 1, the renovation of the Historic Building, and Building 2 will all be constructed within a reasonable time of each other.

Construction work on the Historic Building and Building 2 was to begin within approximately twelve months following completion of construction of Building 1. However, commencement of this construction will be delayed due to the complexities of the negotiations between the parties. Nevertheless, planning for renovation of the Historic Building and construction of Building 2 began before completion of construction of Building 1.

The facts show that these buildings will be constructed on the same site (i.e., the Site), which comprises approximately Y acres of land, separated only by public streets and the Station, which will serve as the focal point of this development. Building 1, the Station, the Historic Building and Building 2 will be interconnected through a sky bridge, the Annex Bridge, and a transportation tunnel. These buildings are all located within the same, discreet Zone.

Lastly, the facts in the submission indicate that the Company will operate the various components of the Site in an integrated manner. For instance, the Taxpayer will market and manage the Site as a single development, seeking economies of scale and the benefits of a significant amount of diverse space available for lease at one site.

The Taxpayer's facts and representations support the treatment of the development as "one project" being constructed pursuant to a common plan that will be completed within a reasonable time, on the same site and used in an integrated manner. Based upon these facts and representations concerning whether the development is one "property" within the meaning of that term in Q&A-6, we conclude that the Historic Building, Building 1, and Building 2 constitute one "property" for purposes of the 35-percent rule in § 168(h)(1)(B)(iii).

We also note that Building 2 and Building 1 will be newly-constructed improvements to land and will be separate properties from the original, no longer existing structures. As a result of the application of the separate improvements rule in § 168(h)(1)(B)(iv), the Use After Transfer Rule of § 168(h)(1)(B)(ii)(IV) will not apply to Building 1 or Building 2, which will not be used or occupied by Government Entity 2 prior to transfer to the Company. See Report of the Senate Finance Committee, S. Rpt. No. 98-169 (1984) to the Deficit Reduction Act of 1984, at pages 129-132.

According to the figures for net rentable floor space provided by the Taxpayer, the percentage of the "property" subject to a disqualified lease is approximately Z percent (i.e., determined by a fraction the numerator of which is the net rentable floor space of the Historic Building (B square feet) and the denominator of which is the total net rentable floor space of the entire project (F square feet²)), which is less than the 35 percent threshold in § 168(h)(1)(B)(iii). Consequently, no portion of the Historic

² This figure includes the parking area to be constructed in the lower levels of Building 2 for the exclusive use of Government Entity 1.

Building, Building 1, or Building 2 will be treated as “tax exempt use property” under § 168(h)(1)(B).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of the transaction described above under any other provision of the Code, including section 47. Accordingly, no opinion is expressed regarding whether the rehabilitation of Historic Building is a “substantial rehabilitation” or a “certified rehabilitation” within the meaning of the applicable rehabilitation credit provisions under section 47, or whether expenditures incurred to rehabilitate Historic Building are “qualified rehabilitation expenditures” under those provisions.

This ruling is directed only to the taxpayer on whose behalf it was requested. Section 6110(k)(3) provides that it may not be cited or used as precedent.

In accordance with the power of attorney, we are sending copies of this letter to your authorized representatives. We are also sending a copy of this letter to the SB/SE Official.

Sincerely,

Charles B. Ramsey
Chief, Branch 6
(Passthroughs & Special Industries)